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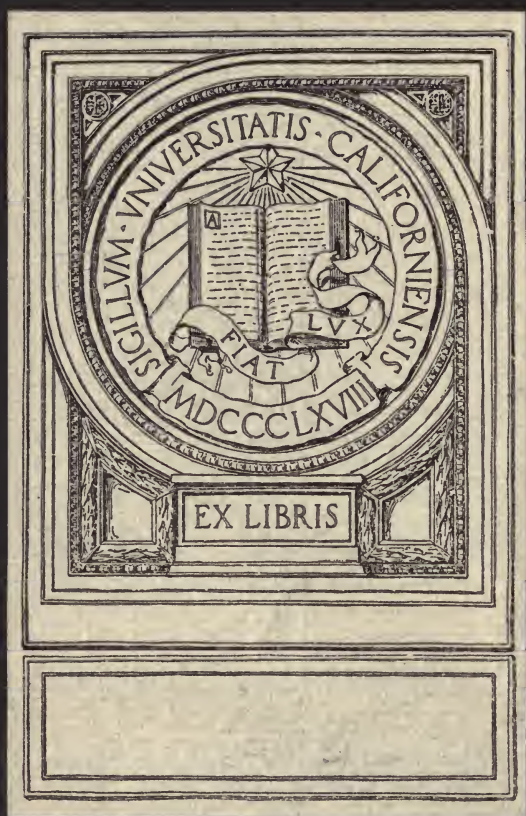
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INDUSTRIAL FINANCE

A COMPARISON BETWEEN

HOME AND FOREIGN :: DEVELOPMENTS ::

BY

L. JOSEPH

===== READ, APRIL 25th, 1911, BEFORE =====
THE NATIONAL ELECTRIC MANUFACTURERS' ASSOCIATION
AT THE INSTITUTION OF ELECTRICAL ENGINEERS, LONDON

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INDUSTRY, also in its concrete application, forms a very broad subject. It is not my task here to-night to deal with all the aspects of industrial development and industrial organisation, these being results of a number of factors and circumstances with which they are closely connected. Legislation, legal technicalities, climatic conditions, geographical situation, traditional usages, constitution of markets, commercial and credit organisation, amongst others, have an important bearing on the industrial evolution in different countries.

We shall confine ourselves to an enquiry into the financial problems relating to industries here and abroad in order to show to what degree the organisation of industries is dependent upon the supply and organisation of capital and credit.

For large enterprises the financier has always been a necessity. In olden times he has been instrumental in finding the means required by kings and princes for expeditions, warfare, etc.; he has also assisted commercial enterprises when in need of capital. But only since mechanical inventions and technical improvements have placed industries generally on an entirely different basis; since the introduction of machinery, power plants, and modern equipment on a large scale have revolutionised business and industrial methods requiring hitherto unheard-of sums of capital—both fixed and circulating—has the financial element played such an important part in our economic system.

On the one hand, old-established concerns were compelled to expand ; on the other hand shrewd men with great foresight and capabilities, recognising the exceptional opportunities before them, wanted command of large amounts of capital for new enterprises, which could not be secured in the ordinary way from private sources. Consequently a change of the business structure was necessary in order to be able to collect capital from the general public to establish capital association on a co-operative basis for employment in remunerative industries. In this way Joint Stock Enterprise, the Company, especially since the form of limited liability had become sufficiently legalised and safeguarded, has more and more taken the place of private business. Railways, mines, iron works, cotton mills, engineering and electrical works, whenever they assume large dimensions are almost invariably operated as limited liability companies.

The theory of a Company, as defined by Hobson, is that "when a number of persons owning some capital which they cannot employ agree to pool their capital so as to form a capital large enough for profitable use in some business which they select, they choose directors to represent their interests, and to exercise a general control over the business subject to their over-ruling at a general meeting of shareholders. The directors appoint managers who are in command over the actual industrial processes, but the supreme and ultimate control always rests with the body of shareholders, and the motive of the undertaking is to furnish them with the largest profit upon this capital."

In theory this definition is undoubtedly correct. However, the actual origin and working of companies are in most cases very different.

Companies are formed either to take over going concerns frequently to facilitate dividing up interests, for family reasons to obtain more capital for expansion, to secure the co-operation of influential parties, or where a new business is started as a company for the exploitation of patents or processes in order to divide the risks, etc. Whatever the case may be, two points are most important :

- (1) That the company is placed upon a sound financial basis, not over-loaded with dead capital, from the beginning ; that the capital of the company is in due proportion to the earning capacity of the undertaking ; that working capital or working credit is in adequate supply.
- (2) That the shares and securities issued by the company are readily marketable in order to be able to raise further funds in the event of the growth of the business, arrangements for amalgamation, fusions, etc., requiring such action.

Evidently therefore the co-operation of the financial agent in one form or another becomes essential from the very inception. Now it seems to me that the difference in the initiation and financial construction of industrial enterprise on the one hand, and the relations between industry and the financial element on the other, are largely responsible for the course which the development of industries has taken in different countries.

Let us see how companies are initiated, promoted, constructed, administrated, and their stocks marketed in England. Suppose some iron manufacturer wishes to convert his business into a limited liability company with a view to gradually retire, or to withdraw some of his own invested capital, or in order to raise additional capital for necessary expansion, or for some of these purposes combined. The most natural thing would be to approach some bank or financial institution, which having had regular dealings with the business ought to be in a privileged position to form an opinion, give advice, assistance and support to carry out the proposed plan, and in respect of the financial organisation of the company, and creating a market in the shares, etc., etc. However, owing to the general principles on which English banks are conducted, the relations between English industry and English banks are only of a very loose and superficial character ; beyond keeping this regular cheque account and an occasional discounting of bills with the bank, there seems to be very little intercourse.

Therefore recourse is taken to the financial agent or promoter, who hitherto may not have concerned himself in the least about the business which probably is an unknown quantity to him. A valuation of the assets is made, such as land, buildings, machinery, stocks; the average earnings for a number of years are calculated; an estimate is made of the goodwill, future prospects, and earning capacity of the business, etc., and the board of directors is arranged, generally composed of partners in the firm, or relatives and friends largely interested and headed by some person of social position. These details are supplied to the promoter, who proceeds to work out the prospectus, making of course ample provision for intermediary profits and dividing the capital into 5%, 6%, or even 7% preference shares, ordinary shares, sometimes also deferred shares. Under certain circumstances funds are raised as well by the issue of mortgage debentures or general charges on the property, machinery, etc. You find on the front page of the prospectus, firstly, the title of the company, the capital, with a description of its rights in respect of the division of profits, etc., the names of the directors, the names of the bankers, brokers, solicitors, auditors, commercial agents, consulting engineers, secretary, and then in the body of the prospectus a more or less full account of the nature of the business, its past and prospective profits, its future plans, etc., a statement of the agreements between the vendors, intermediaries, and the company, and the terms on which subscriptions are invited. There is, however, no indication that any financial firm standing sponsor to the company makes itself responsible for the issue, legally or morally; the prospectus is not signed by anybody. The publication of the names of bankers and brokers means simply and only that they have agreed to act in their respective capacity for the company; it does not imply any responsibility whatever on their part with regard to the issue.

The promoter then approaches certain financial circles in order to get the issue guaranteed by means of underwriting or otherwise, at a commission more or less substantial according to circumstances. This being accomplished, an

issue is made, a special settlement on the London Stock Exchange applied for, and the official quotation obtained if possible. There the function of the promoter, and his interest in the concern, generally ceases, unless he has taken his profit in shares which he usually wishes to turn into cash at the earliest opportunity. The brokers of the Company, as a rule, are in the same way not further concerned in subsequent market developments; having applied for and obtained the special settlement and official quotation for the shares of the company their offices practically come to an end.

Now, necessarily the Company starts with capital inflated as a result of the capitalisation of the goodwill, which is frequently very considerable, and also by the promoting expenses, etc. Formerly, and not many years ago, before the Company Law was revised over and over again, making it compulsory to disclose in the prospectus all the contracts and arrangements between the parties interested in the property and its flotation, and all intermediary profits and commissions—unless some vendor syndicate is formed in order to get around this clause—a very great number of companies were already doomed to extinction at the very outset. Even now not a few companies are still-born, or meet with an ill fate at an early date after their formation. The official records give evidence of thousands of limited liability companies that have to capitulate to voluntary or compulsory liquidation from year to year.

Of course, there are also numerous instances of successful industrial concerns carried on under the Limited Liability Law, and we need mention only such names as Guinness Brewery, John Brown & Co., Brunner, Mond & Co., Huntley & Palmer, J. & P. Coats, Lever Bros., etc., but in the majority of such cases the companies remain more or less under the direction and control of the pre-owners, or of interests that had assisted to a great extent in establishing their reputation and promoting the growth and prosperity of the business, and whose influence is still prevalent. There are certainly not many cases of continued equal prosperity after the control of the business passed out of the hands of pre-owners and persons originally connected with the direction and supervision of the operations.

Great Britain possesses enormous wealth, the savings of centuries derived from trade and industrial activities. The great English industries date back many generations before the German, American, and others came into prominence. Their importance was recognised already a century ago, and their growth was therefore not so sudden as in other countries. Wealthy people usually invest part of their fortunes in industrial undertakings, if they descend from a family engaged in industry. Sometimes they leave the larger part of their means in the business, being satisfied with a seat on the board, generally speaking. The medium capitalist in England is disposed to put a substantial portion of his capital into industrial enterprises in which he takes an active part, and which though a limited company he considers his own. He looks upon his interest as a permanent investment ; should he choose to make a temporary or speculative investment he directs his attention to government stocks, mining shares, etc., such as have an active market on the London Stock Exchange. The small capitalist selects the latter class of securities for his investments. Almost invariably industrial stocks in the narrower sense, that is to say, securities of manufacturing concerns, attract his attention only if he believes he knows everything or something about the business. He buys the shares of a brewery company when an intimate friend connected with the business advises him to do so, or the shares of some iron works, the chimneys of which he sees daily, or of cotton mills when he learns that they want more hands. Industrial stocks here in England have more or less a local character, and are locally held. The interest in these is not widespread and transactions in such stocks on the London Stock Exchange are insignificant as compared with other securities. A glance at the City reports in the London newspapers will satisfy you on this score.

Indeed you will realise that not only are the relations between banks, credit institutions, and industry of an indifferent nature, but also, no doubt indirectly owing to these circumstances, the connection and contact between industry and the stock markets are by no means close ; at all events not so intimate as is desirable, and as is the case in other industrial countries.

As you are aware, English banks, that is to say, London clearing banks, through the gradual absorption of nearly all private and provincial institutions administrate the bulk of the available funds of the nation, which are deposited with them partly free of interest, or at a very low rate. English clearing banks with a subscribed capital of £165,000,000, paid-up capital £34,500,000, and reserves of £24,000,000, have control of deposits amounting to £580,000,000 as per end-year statement. In Germany the three largest institutions have a subscribed and paid-up capital of £28,500,000, a reserve of £11,300,000, and show deposits of £57,900,000, and credit balances of £92,000,000; lumped together, deposits and credit balances amount to about £150,000,000. In explanation I would add that as you will have noticed German banks make a distinction between deposits and credit balances, looking upon the latter as being of a temporary nature; that is to say, they represent capital belonging to trade and industrial undertakings, but unemployed for the time being, whilst the deposits represent loanable capital of a permanent character.

There is hardly any occasion for English clearing banks to undertake transactions which may involve a shadow of risk. They invest their funds in discounting high-class bills, making advances on so-called floaters, gilt-edged stocks and on other securities at ample margin. Credit facilities in its wider application for financing trade and industry are generally speaking outside their sphere. Being able to earn dividends of up to over 20% on their paid-up capital they can afford to leave other departures alone. True, the branch offices of the clearing banks in industrial centres grant overdrafts in some measure, but they are not of great importance; at any rate they cannot be relied upon at all times, and therefore nobody can count upon them absolutely.

It is far from me to criticise the policy of the English deposit banks, which, dictated by the maxims of absolute safety, is evidently the result of mature thought and experience. It is admittedly their duty and aim to employ the funds entrusted to their care in such a manner as to be able to readily meet demands of repayment even in times of distrust

and crises. Depositors in England, by reason of traditional custom more than by their own thought and conviction, take it for granted that credits to industrial enterprises in the form and measure granted by banks on the Continent for instance, involve undue risks, and therefore at any period of uneasiness, severe reaction, or collapse in industry, they would naturally take alarm and withdraw their deposits momentarily. In surveying the influences inimical to industrial developments we have to take these circumstances into account, but I propose to show you later on that such notions do not prevail among Continental depositors; at all events not to such a degree as here.

As for the other banks, merchant bankers and credit institutions, they almost exclusively devote themselves to financing regular commercial transactions which are being liquidated within short periods, such as shipments of merchandise from producing to consuming countries, or to issues of loans, etc. They are not generally concerned with industries, and yet industrial enterprises also require credit in the actual running of their business.

— As a modern economist puts it:—In order that a business may make its maximum earnings, it must secure the quickest turn-over and the largest volume of business. This expansion of the rate and volume of actual business involves the use at certain times of a far larger amount of money than is actually owned by the company, which must buy more than it can pay for in cash, and is obliged therefore to obtain from elsewhere the purchasing power, etc.

— Moreover, it is certainly more conducive to the interest of shareholders if a company by means of credit can raise funds, particularly if needed for temporary use, at a comparatively low rate, than to increase its capital which cannot find constant productive employment. To put it in another way, let us assume that a capital of £50,000 is invested in some concern which is expected to produce a return of 10% per annum. Either these £50,000 must earn the full 10%, or by borrowing additional capital, say for instance £25,000 at the rate of 4%, a return of 8% on the total capital of £75,000, amounting to £6,000, must be attained. This

amount would give a return of 10 % on the £50,000 invested capital after deducting 4 % interest on the borrowed £25,000. This makes it clear that any enterprise taking advantage of legitimate credit facilities in proper measure and on reasonable terms, is increasing its earning unit, and enhancing at the same time its competitive power. The more capital at relatively low rates is employed, the proportionately larger will be the return on the share capital. Therefore since the banks for reasons previously referred to refuse credits to industrial enterprises, it has been the aim of many of the latter to attract such means direct from the public as deposits, and whilst some of the larger concerns confine themselves to the use of the savings of their own employees and workmen deposited with them, it has become a special feature in the cotton spinning industries of Lancashire to finance themselves primarily with the savings received by them as loans from tradesmen, officials, widows, workmen, and others, on which interest up to 5% is allowed. In fact, the paid-up share capital of the cotton companies is relatively insignificant, as a rule only 20 to 25 % being called, the outstanding balance serving as reserve. Needless to point out to you that this method adopted by the Lancashire industries bears a striking resemblance to the lines on which the English clearing banks are worked, the share capital being considered as a guarantee, while deposits form the real working fund. Whether this fashion of employing small savings may be considered as a safe and ideal one from the view point of political economy is a question of no concern to us here to-night. The essential point is that the Lancashire industry itself is greatly assisted, and derives considerable benefit therefrom.

In referring to the American industry one is in the first place impressed by the swift pace of development. There is no equal to American push. Remember that not one hundred years ago America had but little capital, and it was for this reason that already at an early date industrial enterprises were established on the basis of associated capital in the company form, respectively as "corporation" as it is called by our cousins over the water, or "close corporation" if only a few people owned and controlled its capital. These were

one and all more or less local enterprises, inasmuch as only people in the same town or village or neighbourhood, being familiar with the conditions of the particular industry and with the controlling parties, owned the capital. For purely speculative ventures, such as mines, oil springs, etc., the interest of wider circles even in Europe was always invited. The shares of American railroads which are almost without exception subjected to constant and considerable fluctuations are bought only as speculative, hardly ever as permanent investments, whilst railroad mortgage bonds which are in many cases also quoted on European bourses are looked upon as gilt-edged investments in the same manner as high-class government stocks abroad. Holdings of international government securities in America, even at the present time, are utterly insignificant. It is a well-known fact that issues made on the other side, of the English War Loan, Japanese and Brazilian securities, and others, were a failure inasmuch as they were soon afterwards resold to Europe, and as regards the loans issued by the United States Government at a low rate of interest, they are as you know almost exclusively held by the National Banks against their note circulation in accordance with the government regulations.

Industrial stocks, though being quoted on provincial exchanges, have been until recent years excluded from the official listing on the New York Stock Exchange. Only since the formation of the larger trusts, which required the assistance of the stock markets with a view to distributing the newly-created securities, have the authorities of the Stock Exchange recognised the desirability, also in the interest of their institution, to alter their attitude in according a welcome to this class of securities, such as Steels, Smelters, Amalgamated, Sugar and Leather Trusts, Locomotives, etc., etc. The actual dealings in some industrials have at times become so lively and in excess of the turnover in any other active stocks that they more or less monopolised the attention of the markets. Hundreds of thousands of steel shares have changed hands on the New York Stock Exchange over and over again, their price movements influenced many a time the whole market tendency, stimulating or discouraging speculation

which now regards the fluctuations in these shares as a barometer to general trade conditions.

American financiers have taken a keen interest in industrial developments for a considerable time past; J. P. Morgan who is regarded as the leading banker in the States, by identifying himself with the formation of the Steel Trust led the way in officially financing industrial enterprises, and assuming the responsibility for the issue. He labeled, so to speak, industrial financing, and a number of other high-class bankers have followed his example in establishing more intimate connections with industrial groups:—Kuhn, Loeb & Co., with Westinghouse and the smelter interests; Speyer & Co., with Lackawanna steel, Pittsburg steel, and Canadian coal and iron; others with breweries, packing houses, cigar manufacturing concerns, stores, etc. The captains of industry welcomed the co-operation of influential bankers, and wanted the assistance of the Stock Exchange in order to increase their own power to carry out all their far-reaching projects of amalgamations, fusions, trusts, etc., and to popularise their securities, making them more easily marketable, and more acceptable as collateral for advances. The commitments of enterprising American magnates, even of the wealthiest amongst them, are occasionally of such magnitude that it is a matter of importance to them to have no extraordinary difficulties in realising or mobilising part of their interests. This is the more essential as the policy of American banks, though more susceptible to the demands of industry generally, involves on the other hand great dangers as has been proved again in the crisis of 1907.

For some time back the reformation of the complicated banking system in America has been under careful consideration, but so far without result. The different classes of banks, National Banks, State Banks, and Trust Companies, like the English banks, also administrate the available funds of the public. By the regulations of the government they are strictly forbidden to engage in any speculative business, and to grant credit facilities above one-tenth of their own capital to one and the same party. All the banks of the country are subject to the inspection by the Controller of the Federal

Government, a proviso which does not seem of much effective value in view of the fact that there are more than 30,000 banks and trust companies in the United States. Only the National Banks (about 7,000 in number) enjoy the privilege of issuing notes (against government bonds as you know), whilst the establishment of branch offices is prohibited to all of them. This explains the large number of banks all over the country, most of which have only a very small capital (£20,000), especially when compared with the deposits entrusted to their care. As previously stated, the banks are not allowed by law to extend credit facilities to any one party exceeding one-tenth of their own capital. As we have seen, the capital is very insignificant, which makes it impossible for any active concern of some size to satisfy its needs by utilising the offices of one such bank alone. By force of circumstances industrial enterprises are bound to have access to the resources of a number of bank and credit institutions, whilst on the other hand the banks themselves must also find employment for funds under their control in another direction, considering that commercial paper and discounts in the form of bills drawn by mercantile houses on customers, or bankers for account of customers, are non-existent; only export bills drawn on European houses for shipments are held to some extent by banks and bankers in New York. Commercial transactions in the States are based on three or six months' credit, or even for longer periods. It has therefore become customary in America for commercial and industrial concerns to issue and discount their own promissory notes through so-called note-brokers in the market, who, however, do not take any responsibility in the way of endorsement, or direct with the banks all over the country. Mind you, this is paper with only one signature, and it must be patent that the risk is so much greater than if, as is the case in Europe, the signatures of three firms enjoying good credit are required to make it acceptable to the note issuing banks. This single-hand paper in America forms the basis of the currency for the note issue of the National Banks. You quite see the danger of that system in the event of the banks simply withdrawing or curtailing their investments in

promissory notes with a view to increasing their own cash resources in times of uneasiness or crises. Nevertheless, this is the usual way in which American trade, industry and even very large firms, finance themselves. For instance the paper of some of the biggest packing houses is constantly on offer all over the States. Certain enterprises, however, have made arrangements through their New York bankers to also draw on London by way of open credit. These bills are generally endorsed by the New York bankers, who send them to London for discount.

No doubt these difficulties and dangers in financing have influenced in a certain measure the growing tendency in the States towards amalgamations and the formation of trusts. It stands to reason that by enlarging the group of interests, not only their own support, but also that of their financial affiliations could be secured. However, practical experience has given proof that this is not absolutely so. The Amalgamated Copper Trust, for instance, in spite of its powerful connections, failed in the crises of 1901 and 1907 to obtain sufficiently large advances on their copper stocks, and as a consequence the price of copper collapsed. The Westinghouse Company which had enlisted the financial support of a first-class banking group had, to suspend payment in 1907, through want of further capital, shortly after having negotiated a large amount of notes through this banking group. Still, these cases may be considered exceptions.

Within recent years several attempts, partly successful, have been made to place securities of American industrial companies on a larger scale in Europe. The 7% preference shares of well-known enterprises have been offered on attractive terms. The preference capital in these cases represents the actual assets, whilst the ordinary shares having no intrinsic value at the time are representative of the goodwill and the additional earning capacity. In some instances provision is made for the gradual retirement of the preference shares out of profits in a similar manner as debentures would be redeemed. Furthermore, it has been the policy of certain companies the securities of which are also held in some measure in Europe not to distribute all the profits available for the ordinary

shares (after making sufficient reserves) in cash, but partly in cash, and partly in new shares of the company as bonus, husbanding in this way their resources without depriving the shareholders of their rights, and at the same time enabling the companies, as an American financier characterised it, "to grow on their own fat," just like a private firm's partners leave part of their annual profit as additional capital in the business.

American industry is still in need of large amounts of capital. The big companies and trusts are in a better position to raise the necessary funds than smaller concerns, either in the form of credit, or by the issue of capital. The banking community in co-operation with capitalists who themselves have partly made their huge fortunes in industry, such magnates as Rockefeller, Guggenheims, and many others, take an active interest in promoting industrial developments and flotations, whilst the confidence of the general public in these gigantic organisations is obviously increasing with their success. The result is that the progress of amalgamating, combining, and establishing community of interests will continue, unless action is taken to enforce the act which is directed against the trusts. As you know, very important decisions are expected daily which may necessitate some formal reshaping of trust organisations. On the other hand, the contemplated reformation of the banking system must result in beneficial modifications of the financial methods. But whatever may be the outcome in both cases, the principles underlying the industrial development, and the close relations now prevailing between finance and industry cannot become seriously affected.

Much tighter than in England and much more interwoven than in America are the relations between industry and banks and credit institutions in Continental countries, such as Germany, Switzerland, and Austria, except perhaps France. The enormous progress made in Germany especially within the last three decades has been the object of great astonishment for years, and has on many occasions given rise to apprehensions in the financial world as to whether the financial foundations will be strong enough for the rapid

development and expansion of the large industries in Germany; whether the banking interests, in fostering the movement, have not overstepped their mark.

As you are aware, the termination of the Franco-German War of 1871, and the inflow of the war indemnity amounting to £200,000,000, gave a great stimulus to German enterprise. Trade and industry became extremely active; railways were largely extended, the construction of new lines was rushed on a large scale. A number of new banks, classified as "credit mobilier," were established largely in the Provinces. In 1871 a concession was granted for the erection of the Deutsche Bank in Berlin with a capital of £750,000. At that time a government concession was still required for opening banks, but this has since been abandoned.

However, the spirit of enterprise had soon transgressed the limits of solid developments. In the year 1872 the total capital of the credit institutions already amounted to about £55,000,000. A severe reaction set in resulting in 1873 in a crisis, the result of which was that not less than 73 banks with a capital of £21,500,000 were forced to liquidation within the following six years. In 1875 the Imperial Reichsbank, succeeding the Prussian Bank, a government institution, was founded. The Reichsbank is also under the control of the Government, though its capital is privately held. It has the privilege of note issue, and its constitution and functions are upon the whole identical with those of the Bank of England, with that distinction, however, that its power of issuing notes is elastic to a certain degree, whilst its regulations in respect of discounting bills are not so discretionary. In other words, the Reichsbank is compelled to discount regular bills on certain conditions, whilst the Bank of England can refuse to do so. The Reichsbank is managed by the president in conjunction with a Committee the members of which are appointed for life, and controlled by a board of five members, the president of which is the Imperial Chancellor. The interests of the shareholders are represented by a committee of 15 members and 13 alternates, elected by the general meeting, who are as a rule leading bankers and merchants, and whose advice is given due

consideration in the monthly meetings, though they have no actual power with regard to the direction of the affairs of the bank, etc. A deputation of three from the midst of the shareholders' committee keeps in touch with the operations of the Reichsbank by way of inspection and otherwise. The development of the Reichsbank, its able policy and operations, its co-operation with the credit banks, have undoubtedly exercised a beneficial influence upon the whole industrial and banking system in Germany.

You must bear in mind that in Germany and on the Continent generally it is a recognised privilege of the banks, it is their *raison d'être*, to cultivate all branches of banking transactions:—receiving deposits, discounting bills, buying and selling exchange, changing foreign moneys, making advances on securities and merchandise, granting credits, buying and selling securities on commission, underwriting and issuing loans, administering fortunes, guaranteeing contracts, and so forth. By force of circumstances German banks have to devote their attention to all these transactions. German wealth has not yet assumed such proportions, at any rate the loanable capital has not yet increased to such an extent, as to encourage the establishment of deposit banks pure and simple. Any number of proposals which have been submitted during the last twenty years or more have been dismissed, because there really seems no need for division of work and function as in England. (Besides, neither the German capitalists nor the small saving classes are used to leave their money on deposit for any length of time; they are much more eager to invest it in securities.) Moreover, in view of the recognised activities of the banks, the public at large does not find anything disquieting or unsafe in the manner in which they seek employment for funds entrusted to them. Confidence in the administration of the banks, and the integrity and responsibility of the boards of directors who are mostly composed of wealthy and high-class men, and in the ability of the management, has in the course of years been so fortified that only a serious catastrophe could seriously shake it. Can such a calamity happen? It seems almost impossible considering the enormous amount of share capital

and reserves of the big banks, the solidarity of interests amongst them, the efficient control exercised by the boards of directors, and the influence and assistance of the Reichsbank as the last resort.

You might remind me of the Leipziger Bank and of the Niederdeutsche Bank failures, the former in 1901, and the latter only last year. The Leipziger Bank failure, certainly a serious matter, was due to the lack of supervision by the board, who placed implicit confidence in its manager who in reality governed the Bank ; but after all the Leipziger Bank was one of the few provincial institutions left, which was not in one way or another controlled by the big Berlin institutions. The conditions there were exceptional, and since then the checking system in all the banks has been very considerably improved. Even in the case of the Leipziger Bank depositors did not suffer any loss. The example of this bank therefore cannot be considered as a proof against my contention, much less the Niederdeutsche Bank, and other smaller institutions that failed recently ; you might just as well use the failure of the Charing Cross Bank and some smaller concerns as an argument against the English banking system.

Let me give you some figures of the position of 46 German banks (institutions with a capital below £500,000 are left out of consideration) at the end of 1910. The paid-up share capital amounted to £119,000,000; the reserves to £31,000,000, that is to say about 25%. The deposits amounted to £127,000,000, the credit balances to £240,000,000, together £367,000,000. Proportion of own capital to deposits, about 40 %.

The Assets were:—

Cash and balances at the Reichsbank, etc.	£ 48,000,000.
Bills receivable	£128,000,000.
Advances on stock exchange securities ...	£111,000,000.
Investments... ..	£ 29,000,000.
Syndicate and other participations ...	£ 19,000,000.
Debtors	£261,000,000.

and Liabilities:—

Deposits and credit balances	£367,000,000.
Acceptances... ..	£ 97,000,000.
Guarantees	£ 33,000,000.

The quickly realisable assets, leaving out syndicates and other participations, and naturally debtors, amounted to £316,000,000, against liabilities of £495,000,000, the proportion being roughly 65%. Considering that amongst the debtors owing £261,000,000, partly covered, there are assuredly a great many who, if called upon, could make good their obligations almost instantly, and further taking into consideration that the heavy requirements towards the end of the year naturally influenced the status unfavourably (trade and industry were very active in Germany in 1910) there seems certainly no cause for concern. The process of concentration that has been going on for years in Germany, and is still going on, and the growing responsibilities of the enlarged boards of directors make, no doubt, for still greater circumspection and care in the future without necessarily affecting the policy of encouraging industrial development. The stronger the banking institutions become from year to year by building up reserves and increasing their capital, the more they raise the public confidence in their power and foresight, so much better will they promote the interests of industries.

You have seen that the industrial activity which set in after 1871 was overdone. Industrial development, however, received an intense and lasting stimulus by the nationalisation of the railways which until then were privately owned, directly because extensions and improvements were taken in hand on a large scale, indirectly because very considerable amounts of capital became dislocated, seeking employment in other directions.

The leading financial circles, conscious of the importance of this economic change, commenced immediately to direct the flow of capital towards industrial enterprises of all descriptions, especially iron works, collieries, machinery manufactures, engineering and electrical establishments, etc., by way of promoting and floating companies, etc. Meanwhile the Company Law has been greatly reformed and improved, protecting the public in every possible way from being deceived or misled by misstatements in the prospectus in respect of goodwill or otherwise. Under all circumstances

(two annual balance sheets of the Company after its registration have to be submitted, before the securities can be introduced on the market. Most stringent regulations as to the responsibility of directors have been formulated. The prospectuses have to be signed by the issuing firms who thereby make themselves responsible for the correctness of statements, and at the same time place their prestige and credit as issuing houses at stake. A committee of able bankers and merchants appointed by the Government is authorised to demand any necessary explanations after most careful and searching investigation into the facts and figures in the prospectus, has to express its opinion as to the desirability of allowing the security in question to be introduced and quoted on the Stock Exchange. All these precautions are most beneficial in creating an atmosphere of confidence and trust for industrial stocks, the more so as the banks themselves are invariably represented on the board of directors, and exercise considerable influence in the management of affairs, not only in its financial but also in its general aspects. The experience of bankers connected with a vast number of different concerns, and thereby gaining inside knowledge of different industries, is often very valuable even in technical matters, in questions of amalgamations, combinations, cartels, etc. They are enabled to look at problems and situations not only as to how they will affect that particular company or industry, but from the point of view of the whole economic fabric in which they are greatly interested. Two examples will give you an illustration. Some years ago the Government was at work, to secretly acquire by purchases in the market the control of an important coal mine in order to become less dependent on the coal syndicate for the supply of its railways. The chief of a large Berlin institution, intimately connected with that coal company devised the means of instantly increasing the share capital of the company, in order to prevent the government from exercising a controlling influence. Action was taken by the government in order to obtain a cancellation of the issue, holding that it was illegitimate, but the case was decided against the government. True, the banking institution defended its own interest in the first place, but

surely that of the whole industry as well. In another case the manager of very large iron works objected to the company joining the Steel Union. Admittedly it would have been to the advantage of that particular company to abstain, but the banking interests considering it necessary for the sake of the industry as a whole insisted and succeeded in bringing these works into line, the manager resigning his position in consequence. In this way the individual interests are being subordinated to the interests of a larger community.

It is, I believe, safe to contend that the constant shifting and changing, adding, adapting, and combining in the industrial development is due as much to the banking influence as to the leaders of industry themselves. The formation of the cartels, syndicates, the combination of iron works and collieries, the former acquiring the latter, and *vice-versa*, are as much the doings of the financiers as of the captains of industry. Being so conversant with all the affairs of industries, and keeping in constant intimate touch, it is quite logical that the banks are always ready to assist industries even in times of stress. They make advances to them for extensions, for new equipment, for acquiring discreetly if necessary competing works, etc. These transactions which naturally in themselves are profitable to them will finally result in further issues of capital, and placing and marketing of shares, etc., by which they again secure fresh revenues. They do not, and cannot consider their function at an end with the issue of the capital; they recommend the securities to their own clientele, and they regulate the market if there is need. Important transactions in industrial securities take place daily on the Berlin and other German bourses. The public knows that these investments not only are of intrinsic merit, but also that they can be easily disposed of even in times of reaction in trade.

Under the banking influence it has become more and more the policy of industrial companies to build up such reserves as to be able to avoid too sharp fluctuations in the dividend distributions. The balance sheets of some companies give unmistakable evidence. I have got here the figures of Siemens & Halske, showing that since 1901 the capital has

been increased from £2,700,000 to £3,150,000, the open reserve from £460,000 to £740,000, permanent investments from £560,000 to £3,200,000; buildings are unchanged at £500,000; tools, machinery, lighting plant, etc., are written down from £480,000 to 1s.; raw material is reduced from £300,000 to £100,000, manufactured and half-manufactured goods from £1,200,000 to £450,000, power station from £160,000 to £40,000, interests in other enterprises from £250,000 to £35,000. These figures tell a great tale. The permanent investments alone, as a result of the arrangement with Schuckert & Co., etc., exceed the whole share capital. On the other hand, buildings stand at the same amount regardless of the enormous extension of the works; tools, machinery, lighting plant, etc., have been written down to the extent of £480,000; stocks of raw material are valued at one-third of their book-price of nine years ago; manufactured and half-manufactured goods are £700,000 less in spite of the great increase in the business. Anybody that can read a balance sheet will recognise the enormous reserves which are hidden in these figures. The dividends since 1901 have been as follows: 8%, 4%, 5%, 7%, 9%, 10%, twice 11%, twice 12%. The policy of stabilising dividends, or rather to establish a minimum basis from which to advance but not to retreat, seems hardly disguised.

Much more imposing still are the figures of the Allgemeine Elektrizitäts-Gesellschaft, that remarkable institution founded in 1813 as an off-shoot of Siemens & Halske, with a capital of £250,000 which has since gradually risen to £6,500,000, with probably not much less reserves. Machinery, tools, models, and patents of each single factory controlled by the company have been written down to 1s. This will give you an idea to what extent the company has built up secret reserves in other ways. The last balance sheet, when the capital was still £5,000,000, shows credit balances at banks amounting to £2,600,000. Needless to say that this institution is no longer dependent on banking credit, nor would it find great difficulties in placing its securities without the assistance of bankers. Still the intimate relations between the banks and the A. E. G.

still exist; representatives of all the leading banks are on its board, evidently their co-operation is of direct and indirect benefit, and not because they are representing large shareholders. I do not wish to make out that these companies are typical examples; not every concern practises such extraordinarily conservative principles. Few can afford to divert such sums of their profits to reserves, but there is no question that upon the whole the industrial companies are well advised in their financial policy, which will aid in popularising their securities to a still greater extent.

We find also amongst English companies such examples, for instance J. & P. Coats which Company has increased its capital from £9,000,000 to £10,500,000 since 1901, at the same time reducing outstanding debentures from £2,000,000 to £500,000. The open reserve fund is now £6,578,000 which is £5,604,000 higher than in 1901. Although such cases are exceptions, they are well appreciated by the public. The shares of J. & P. Coats stand at a price which on the last dividend basis returns less than 3%.

It is generally acknowledged that the progress made in the electric industries in Germany has been most striking. Without disregarding any other factors conducive to this remarkable development, it seems to me that it was due in a large measure to the intelligent and most liberal assistance of the financial circles that have quickly grasped the importance of this new industry. They have enabled electrical undertakings to secure work in both hemispheres by financing them through all the different stages, they have been instrumental in affiliating their own financial trusts and holding companies to the electric companies, and they have distributed into the investing channels the securities of all their enterprises, debentures, and shares. Without such faithful and powerful support the electrical industries would never have forged ahead with such speed, and would not have acquired the commanding position which they hold.

In submitting to you a rough sketch of the financial construction and organisation of the industries in different countries I believe to have shown:—that industrial credit does not necessarily involve banks in undue risks; that the

organisation of the Continental banks, which are essentially credit institutions, is efficiently equipped both financially and intellectually to cope with the industrial requirements; that the co-operation between banks and financial institutions and industries have proved upon the whole salutary to both; that the assistance of well organised stock markets is needed to place and popularise industrial stocks as investments. It seems to me that for practical purposes it is more essential to give attention to these points than to fiscal problems which have been under discussion for a considerable time. I will not tax your patience any longer in touching upon that subject, but conclude by thanking you very much for your kind attention.

Yours very truly,
J. M. Smith



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